

STATEMENT OF
GORDON CAIN,
DEEPWATER LAND MANAGER,
CHEVRON NORTH AMERICA EXPLORATION AND PRODUCTION COMPANY,
A DIVISION OF CHEVRON U.S.A. INC.,
BEFORE THE COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON ENERGY AND RESOURCES,
UNITED STATES HOUSE OF REPRESENTATIVES,
JULY 27, 2006, HEARING

Mr. Chairman and Members of the Subcommittee, on behalf of Chevron, I wish to express our appreciation at having the opportunity to appear before the Subcommittee to discuss the Department of the Interior's deepwater royalty relief program.

As requested in your invitation to testify, my testimony will discuss the quarterly American Association of Professional Landmen meetings during which the absence of price threshold language in specific deepwater leases was raised with Mr. Chris Oynes, the MMS regional director for the Gulf of Mexico. In addition, you have asked me to discuss my recollection of Mr. Oynes' reaction, as well as to provide you with any other correspondence I may have had with the Interior Department during the 1995 to 2000 time period regarding price thresholds or related issues.

As stated in our letter to the Chairman on July 10, 2006, I came to the present Chevron organization from the legacy Chevron Company and participated in meetings with the MMS in the course of which 1998 and 1999 lease royalty relief issues were raised. (In 1998, Chevron U.S.A. Inc. (Chevron), Texaco Exploration and Production Inc. (Texaco), and Union Oil Company of California (Unocal) were separate companies. Through a series of mergers and acquisitions, Texaco and Unocal are now owned by certain Chevron subsidiaries and affiliates.) In 1998 and 1999, I was Chevron's Gulf of Mexico Land Manager. I continue to hold that position today, except my duties no longer include certain activities involving deepwater exploration. As land manager, I am responsible for all leasing activities in the shallow waters of the Gulf and for Chevron's producing operations throughout the Gulf.

I am not currently a member of the American Association of Professional Landmen's (AAPL) Outer Continental Shelf (OCS) Committee (the AAPL Committee). Mr. Couvillion is now the Chevron representative on the Committee. The AAPL Committee varies in size from year to year, but normally consists of representatives of 20 or more companies engaged in oil and gas exploration and production on the United States OCS. For many years, members of the AAPL Committee have met once per quarter with the MMS, generally with the Gulf of Mexico Regional Director Chris Oynes and his staff, to discuss a variety of issues related to the MMS's administration of offshore oil and gas leasing. I participated in most of the quarterly and annual meetings with MMS in 1998, 1999, and 2000.

I recall an AAPL Committee meeting with Mr. Oynes and his staff that took place in the fall of 1998 where the price threshold issue first was raised. During that meeting, an inquiry arose

about a change in deepwater royalty relief lease provisions in the leases issued as a result of the OCS Lease Sale 169, which was held in March 1998. As you know, the 1996 and 1997 deepwater leases included an addendum specifically detailing the terms and conditions of royalty relief applicable to each lease. The 1998 leases, however, had no such addendum. In the fall 1998 meeting, Mr. Oynes and his staff were questioned as to why royalty relief volume suspensions, price thresholds, and other matters were no longer detailed in addenda to the leases. Mr. Oynes and his staff indicated that they believed the omitted provisions were no longer necessary because the MMS had finalized its royalty relief regulations. They further indicated that they believed the appropriate deepwater royalty relief terms and conditions were incorporated in the 1998 leases by language making the leases subject to the new royalty relief regulations. That explanation was accepted by the AAPL Committee members, and the issue was not further pursued at the fall 1998 meeting.

After the fall 1998 meeting, members of the AAPL Committee reviewed the Deepwater Royalty Relief Act and the MMS regulations implementing the Act. However, they concluded that neither the Act nor the regulations explicitly contained price threshold provisions applicable to leases issued in 1995 through 2000. In a 1999 meeting, several AAPL Committee members mentioned this to Mr. Oynes. Mr. Oynes indicated that his staff would review the issue.

After Chevron received its leases purchased in OCS Lease Sale 175 (held in March of 2000), it was noted that the leases included an addendum addressing deepwater royalty relief. Like the addendum used in 1996 and 1997, the new addendum detailed the royalty suspension volumes, price thresholds, and other related matters. In an AAPL Committee meeting with MMS in 2000, Mr. Oynes and his staff were asked about the apparent decision to revert to using an addendum containing specific deepwater royalty relief provisions. The MMS representatives indicated that in their view the addendum was necessary to ensure that lessees understood the royalty relief terms and conditions applicable to their deepwater leases. In subsequent discussions with Mr. Oynes later in 2000, and again in 2001, Mr. Oynes indicated that the MMS had concluded that price thresholds would not apply to deepwater leases issued in 1998 and 1999 because neither the leases nor the regulations cited in the leases contained price thresholds.

I do not have notes or written correspondence detailing any discussions with the MMS regarding the omission of price thresholds from the 1998 and 1999 leases. Our normal practice is to retain work files covering AAPL Committee activity for only a few years. Further, I should note that in the late 1990s the inclusion or absence of price thresholds in deepwater leases was not a significant issue for Chevron or any other participant in the OCS program. In the late 1990s, the companies did not anticipate the threshold prices established in the 1996 and 1997 leases would be exceeded in the near or even distant future. In that era, the most significant royalty relief issues for the companies were MMS's implementation of royalty relief on a field basis, instead of by lease, and the complex royalty relief application process created by MMS for deepwater leases in existence prior to passage of the Deepwater Royalty Relief Act. These issues, rather than price thresholds, dominated discussions of royalty relief in the late 1990s.

Chevron continues to meet periodically with the MMS Regional office personnel both through the vehicle of the AAPL Committee as well as individually to address issues related to new regulations, notices issued to lessees, offshore operations, and other topics important to

Chevron's participation in the OCS leasing program. While we do not always agree with the MMS, we believe they do a highly conscientious job, particularly when one considers the magnitude and scope of the OCS program.

Chevron appreciates your continuing interest in deepwater royalty relief issues. Chevron believes that the Deepwater Royalty Relief Act has been a national success in that it has provided incentive for domestic energy companies to purchase deepwater leases and to explore for oil and gas on the leases at a time of historically low prices. Investments in deepwater exploration would not have been made in that unfavorable price environment without the incentive of royalty relief. However, these investments will now begin producing in the near term. These investments will soon generate much needed new supplies of oil and gas that are essential in the current unstable and highly constricted market. In addition, bonuses and rental payments for deepwater leases have already generated considerable revenue for the federal government.

It is easy in 20-20 hindsight to second guess the omission of language specifically dealing with thresholds from leases sold in the 1998 and 1999 lease sales. However, at the time these leases were entered into, it seemed most unlikely that the established thresholds would be exceeded or, indeed, would have any relevance. Further, in contemplating new thresholds for deepwater leases in today's environment, Chevron believes that the recent drastic increases in exploration and production costs should be considered. As oil and gas prices have risen across the world, it has become dramatically more expensive to procure the services and equipment necessary to explore for oil and gas in our domestic deepwater as well as in other parts of the world. One clear example is the massive increase in cost for deepwater drilling rigs, which have doubled in the past year and can now run well in excess of \$500,000 per day. Another example is our recent attempt to drill an exploratory well at our North Bob prospect. Chevron and its partners have spent approximately \$95 million in an unsuccessful attempt to evaluate that prospect.

In closing, I would like to reiterate that, as Mr. Siegele indicated at the June 21 hearing, Chevron is more than willing to meet with the MMS to discuss the issue of the omission of thresholds in the 1998 and 1999 deepwater leases. In fact, we are pleased to inform you that we are scheduled to meet with the MMS tomorrow to determine the best way to resolve this issue in a fair and equitable manner.